

This section provides an overview of the state's current situation involving bond debt. It also discusses the impact that the bond measures on this ballot would, if approved, have on the state's debt level and the costs of paying off such debt over time.

Background

What Is Bond Financing? Bond financing is a type of long-term borrowing that the state uses to raise money for various purposes. The state obtains this money by selling bonds to investors. In exchange, it agrees to repay this money, with interest, according to a specified schedule.

Why Are Bonds Used? The state has traditionally used bonds to finance major capital outlay projects such as roads, educational facilities, prisons, parks, water projects, and office buildings (that is, infrastructure-related projects). This is done mainly because these facilities provide services over many years, their large dollar costs can be difficult to pay for all at once, and different taxpayers benefit over time from the facilities. Recently, however, the state has also used bond financing to help close major shortfalls in its General Fund budget.

What Types of Bonds Does the State Sell? The state sells three major types of bonds. These are:

- **General Fund-Supported Bonds.** These are paid off from the state's General Fund, which is largely supported by tax revenues. These bonds take two forms. The majority are *general obligation* bonds. These must be approved by the voters and their repayment is guaranteed by the state's general taxing power. The second type is *lease-revenue* bonds. These are paid off from lease payments (primarily financed from the General Fund) by state agencies using the facilities the bonds finance. These bonds do not require voter approval and are not guaranteed. As a result, they have somewhat higher interest costs than general obligation bonds.
- **Traditional Revenue Bonds.** These also finance capital projects but are not supported by the General Fund. Rather, they are paid off from a designated revenue stream—usually generated by the projects they finance—such as bridge tolls. These bonds also are not guaranteed by the state's general taxing power and do not require voter approval.
- **Budget-Related Bonds.** In March 2004, the voters approved Proposition 57, authorizing \$15 billion in bonds to help pay off the state's

accumulated budget deficit and other obligations. Of this amount, \$11.3 billion was raised through bond sales in May and June of 2004, and \$3.7 billion is available for later sales. The impact on the General Fund of paying off these bonds is an annual cost of about \$1.5 billion. (Current law also allows for additional debt-service payments from the Budget Stabilization Account—BSA—established by Proposition 58 in order to pay off the bonds earlier.) The bonds' repayments are also guaranteed by the state's general taxing power.

What Are the Direct Costs of Bond Financing?

The state's cost for using bonds depends primarily on the amount sold, their interest rates, the time period over which they are repaid, and their maturity structure. For example, the most recently sold general obligation bonds will be paid off over a 30-year period with fairly level annual payments. Assuming that a bond issue carries a tax-exempt interest rate of 5 percent, the cost of paying it off with level payments over 30 years is close to \$2 for each dollar borrowed—\$1 for the amount borrowed and close to \$1 for interest. This cost, however, is spread over the entire 30-year period, so the cost after adjusting for inflation is considerably less—about \$1.30 for each \$1 borrowed.

The State's Current Debt Situation

Amount of General Fund Debt. As of July 1, 2006, the state had about \$45 billion of infrastructure-related General Fund bond debt outstanding on which it is making principal and interest payments. This consists of about \$37 billion of general obligation bonds and \$8 billion of lease-revenue bonds. In addition, the state has not yet sold about \$30 billion of authorized general obligation and lease-revenue infrastructure bonds. Most of these bonds have been committed, but the projects involved have not yet been started or those in progress have not yet reached their major construction phase. The above totals do not include the budget-related bonds identified above.

General Fund Debt Payments. We estimate that General Fund debt payments for infrastructure-related general obligation and lease-revenue bonds were about \$3.9 billion in 2005–06. As previously authorized but currently unsold bonds are marketed, outstanding bond debt costs will peak at approximately \$5.5 billion in 2010–11. If, in addition, the annual costs of the budget-related bonds are included, total debt-service costs were \$5.1 billion in 2005–06, and will rise to a peak of

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\$8.4 billion in 2009–10. (These amounts assume additional repayments from the BSA.)

Debt-Service Ratio. One indicator of the state's debt situation is its debt-service ratio (DSR). This ratio indicates the portion of the state's annual revenues that must be set aside for debt-service payments on bonds and therefore are not available for other state programs. As shown in Figure 1, the DSR increased in the early 1990s and peaked at 5.7 percent before falling back to below 3 percent in 2002–03, partly due to some deficit-refinancing activities. The DSR then rose again beginning in 2003–04 and currently stands at 4.2 percent for infrastructure bonds. It is expected to increase to a peak of 4.8 percent in 2008–09 as currently authorized bonds are sold.

Effects of the Bond Propositions on This Ballot

There are five general obligation bond measures on this ballot, totaling \$42.7 billion in new authorizations. These include:

- Proposition 1B, which would authorize the state to issue \$19.9 billion of bonds to finance highway safety, traffic reduction, air quality, and port security.
- Proposition 1C, which would authorize the state to issue \$2.85 billion of bonds for housing and development programs.

- Proposition 1D, which would authorize the state to issue \$10.4 billion of bonds to finance kindergarten through university education facilities.
- Proposition 1E, which would authorize the state to issue \$4.1 billion of bonds for flood control projects.
- Proposition 84, which would authorize the state to issue \$5.4 billion of bonds to fund various resource-related projects.

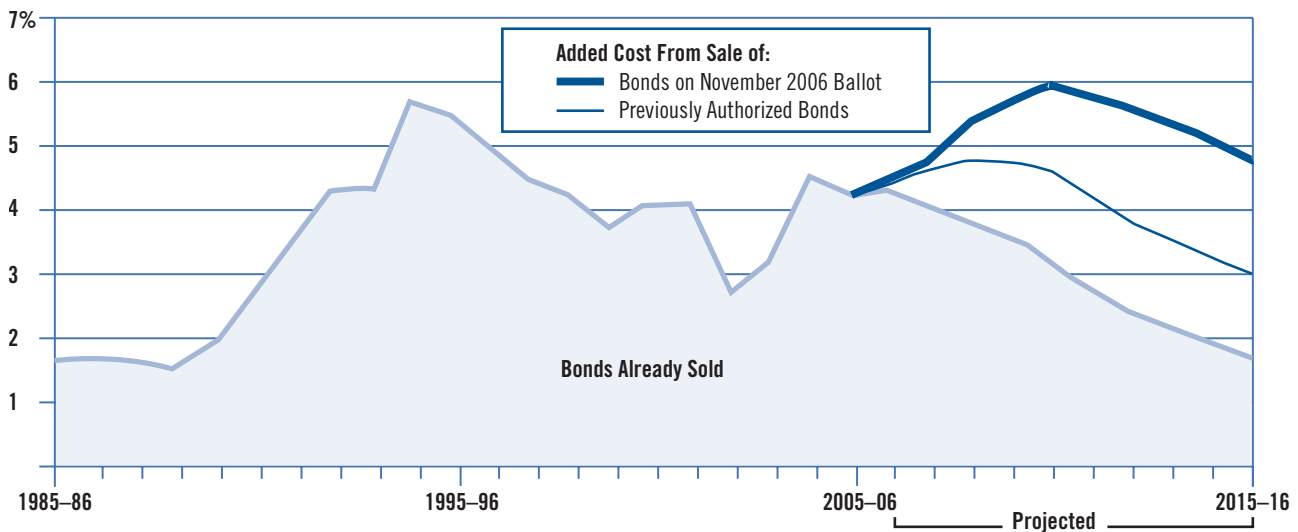
The first four measures make up an infrastructure bond package approved by the Legislature and Governor. The fifth measure was placed on the ballot through the initiative process.

Impacts on Debt Payments. If the \$42.7 billion of bonds on this ballot are all approved, they would require total debt-service payments over the life of the bonds of about twice that amount. The average annual debt service on the bonds would depend on the timing of their sales. If they were sold over a 10-year period, the budgetary cost would average roughly \$2 billion annually.

Impact on the Debt-Service Ratio. Figure 1 shows what would happen to the state's DSR over time if all of the bonds were approved and sold. It would peak at 5.9 percent in 2010–11 and decline thereafter.

FIGURE 1

General Fund Debt-Service Ratio^a



^aRatio of debt-service payments to revenues and transfers. Excludes budget-related bonds.